minimising fraud and
maximising results in the
international mining sector
how the mining sector can improve
profitability by cutting the cost of fraud
Jim Gee and Dr. Mark Button
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INTRODUCTION

The International Mining Sector faces numerous financial pressures that impact on its profitability, many of which are specific to the sector. Since the start of the global financial crisis there has been a significant upward shift in the cost base in the mining industry. This has occurred as a result of increasing energy prices, rising construction costs, the emergence of a skills shortage, the fact that new resources are being discovered in increasingly challenging places and increasing resource nationalism in many countries. These cost pressures are having an impact on margins even in a strong commodity price environment. Hence we will see consolidation driven by the increasing economies of scale.

There are many costs that the sector identifies and takes into account, however another business cost, of equal impact and significance, has rarely been accurately quantified by the sector – the cost of fraud.

Fraud can lead to less financially stable and healthy companies and its reduction can also significantly improve profitability; it can result in raw materials being more expensive than they should be and its reduction can significantly improve value for money. These positive outcomes arise from the financial benefits derived from the reduction of the significant cost which fraud represents.

PKF’s new report provides an unprecedented insight into the benefits to the international mining sector of reducing the cost of fraud. In uncertain macro-economic times, cutting the cost of fraud - revealed by the latest global research to represent, on average, 5.7% of expenditure - can massively boost profitability and financial health.

Developments over the last decade or so, to accurately measure the cost of fraud like any other business cost, has allowed organisations from many different sectors, and across the world, to manage and minimise that cost. PKF has worked with mining companies globally to help them do this, and, as a result of that work, those companies are already benefiting.

The report outlines the results of research to review data from 58 of the world’s international mining companies with total sales of more than $US 734 billion. We have also examined the position affecting the 94 mining companies registered on the FTSE 100, FTSE 250, FTSE AIM 100, FTSE AIM All Share, FTSE UK 50, FTSE Small Cap, FTSE Fledgling listings where information was available for the last financial year. The effect on companies’ results is dramatic, whatever the size of the company.

Later in 2012, a book by the authors of this report - Countering Fraud for Competitive Advantage - will be published globally by John Wiley and Sons. It will expand on the themes in this report and explain what companies need to do to gain the competitive advantage. What is clear is that fraud - the last great uncontrolled business cost - can now be measured, managed and minimised - both in the international mining sector and beyond.

Jim Gee and Dr Mark Button
1 //

the size of the problem
1. If you don’t understand the nature and scale of the problem how can you apply the right solution? Over the last decade or so it has become possible to accurately measure the nature and scale of fraud – and then to design an informed strategy to address it.

1.2 Fraud is a challenging problem. Its economic effects are clear. In every sector of every country, fraud has a pernicious impact. However, historically, fraud has been described as ‘difficult to cost’ and until relatively recently, it has not been possible to quantify these effects. In the last 10 - 15 years this situation has changed.

1.3 ‘The Financial Cost of Fraud Report 2011’ represents the latest, most extensive global research in this area. The report documents what has been found, across the world, over a 12 year period. It also shows the impact of the recession on losses by comparing and contrasting data from 2008 and 2009 with the prior period. It focuses on presenting a credible, accurate and statistically valid picture, in a context where the quality of some information has historically been poor.

1.4 There are still some estimates published which are simply not reliable. Counting only those losses which are detected or prosecuted, or surveying those working in the area for their opinion, will never be accepted as a reliable indicator of the real economic cost of fraud.

1.5 Unless one imagines that all fraud can be detected – and research tends to indicate that, at best, organisations can only detect in the region of 1/30th of it – then a measure of fraud based on detected losses will always represent a serious underestimate. Bearing in mind that even the crime of murder doesn’t have a 100% detection rate and that the essence of fraud is about concealment, it is unlikely ever to be the case that what is detected will represent the totality of the cost.

1.6 Surveys of opinion are also unreliable. The Association of Certified Fraud Examiners (ACFE) in the United States produces an annual survey of this type. Its most recent edition states that “Survey participants estimated that the typical organization loses 5% of its annual revenue to fraud.” Such surveys can represent a reliable reflection of the opinion of those surveyed (if the sample is representative) but, in the absence of an examination of actual items of expenditure, and the collation of evidence of correctness, error and fraud, they are not grounded in fact.

1.7 It is now possible to do much better than this. The financial cost of fraud and error can be accurately measured in the same way as other business costs. This is not unnecessarily costly or difficult, and most important, an accurate, statistically valid figure can be provided for what the financial cost is estimated to be.

1.8 The latest global research indicates that losses to fraud average 5.7% of expenditure. When measured across 32 types of expenditure with a total value of £5 trillion, and in several different countries, just under 70% of accurate and statistically valid measurement exercises revealed losses of 3% or more. This figure rose to over 75% for the period after the recession of 2008 – 2009. In the two years for which data is available after the recession commenced the cost of fraud rose by over 30%.

1.9 So, research leaves little room for doubt that fraud represents a significant cost.

1.10 Indeed, if we take the percentage figure for global losses (5.7%), as a proportion of the global Gross Domestic Product (GDP) for 2011 ($US69.9 trillion or £43.5 trillion), this equates to $US 3.98 trillion or £2.48 trillion, a sum larger than the GDP for Germany.

1.11 So it is clear that the cost of fraud is significant and can and has been measured in many different types of organisation. The next logical question concerns the extent of the competitive advantage to be gained from reducing this cost in the international mining sector and how quickly it can be realised.

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1. ‘The Financial Cost of Fraud Report 2011’ published by PKF (UK) LLP and the Centre for Counter Fraud Studies at University of Portsmouth – Jim Gee, Dr Mark Button and Graham Brooks

2. ‘ACFE: ‘2010 Report to the Nations’

3. ‘The Financial Cost of Fraud Report 2011’ published by PKF (UK) LLP and the Centre for Counter Fraud Studies at University of Portsmouth – Jim Gee, Dr Mark Button and Graham Brooks

4. Losses to fraud and error

5. IMF Data - Nominal GDP list of countries for the year 2011. World Economic Outlook Database-September 2011
2 // the nature of the problem
2.1 PKF researched and reported on fraud in mining in its ‘Fraud in the International Mining Sector’ report, published jointly with the Centre for Counter Fraud Studies at University of Portsmouth. The report identified the key vulnerabilities of mining companies:

Difficult operating environments

2.2 The challenging geographies and climates where many mines are located often present significant difficulties. Mines are also sometimes relatively inaccessible, especially at the commencement of operations, as infrastructure is not yet in place.

Shortages of skilled local staff

2.3 A regular problem for mining companies is not being able to recruit sufficient numbers of specialist local staff to be able to conduct their operations as they would wish – close to and benefitting local communities. This is not something which can be solved short-term, and despite strenuous efforts to develop skills locally, is a problem which can exist for many years after operations commence.

Local political tensions

2.4 Valuable and scarce natural resources are sometimes located in developing countries which don’t have the level of stability, governance and democracy which would be ideal. Operating in such countries requires the acquisition of strong local contacts and advice – something which has to be achieved without appearing to support one side or the other politically.

Weak anti-fraud and anti-corruption cultures

2.5 Of the 54 countries where most mining takes place, 36 or almost 70%, are rated at 4 or less on the Transparency International Perceptions of Corruption Index, where 10 is very clean and 0 is highly corrupt. This reflects the difficulties that many countries where mining takes place have, in developing and sustaining a strong anti-fraud culture.

Focus on physical security and theft

2.6 Necessarily, mining companies protect themselves physically in often very challenging geographies. The quality of many of those who lead and undertake this work is undoubted, however, fraud represents a different type of threat compared to, for example, the theft of diesel. It involves concealment, and both practical experience and global research indicates that the greatest proportion of fraud lies undetected, unless specific proactive work is undertaken.

2.7 Recent global research, across a massive £5 trillion dataset, has revealed that losses average 5.7% of expenditure with an increase of more than 30% since the onset of the recent recession. The fact that the greatest part of this cost involves high volume, low value fraud also makes it less visible (and apparently less worthy of attention) than is in fact the case. Furthermore, the ever increasing complexity of processes and systems and the development of technology, provide opportunities for fraud, unless organisations make them fraud resilient. Where they do, reductions in losses of up to 40% within 12 months have been achieved.
Some case studies …

Case study 1

2.8 PKF were asked to undertake a review of the fraud resilience of one of the world’s biggest copper mines in East Africa. The mine had a very active Head of Security who wanted to know how well his mine was protected against fraud. He sought a ‘helicopter view’ of his organisation, showing the strengths and weaknesses of its protection together with an overall fraud resilience rating and a relative view compared to other peers. More than 20 key staff were interviewed and a wealth of documentation was examined.

2.9 Parallel to the fraud resilience review, extensive fraud awareness training took place, with over 200 managers and staff participating in interactive, group-based training. Over 95% of those trained, when surveyed, indicated that they felt that the training had made a very significant contribution to strengthening the anti-fraud culture at the mine.

2.10 Work also took place to ensure that IT systems and networks were secure and details of operational activity and intellectual property could not be accessed inappropriately. This ‘network penetration testing’ both identified some areas where additional security was needed and provided a level of assurance (in this case) that nothing too serious was wrong.

2.11 Finally, PKF were asked to undertake a data analytics exercise involving more than 70 separate tests concerning the mine’s expenditure on supplies and services. This work identified some key issues which needed addressing and allowed the mine to reduce losses to fraud and error.

Case study 2

2.12 Another example of PKF’s work involves one of the world’s largest gold and copper mines in South East Asia. A forward thinking principal security advisor approached PKF as specialists in mining fraud, and we were again asked to undertake a fraud resilience review, to assess how well the mine was protected against fraud, and fraud awareness training for staff and managers.

2.13 The training was successfully delivered to over 800 people, and the fraud resilience report highlighted the strengths and weaknesses of the mine’s protection against fraud.

2.14 This lead to further innovative work providing a digital map of the telephone, mobile and Email communications at the mine. The content of the communications was not examined, but a visual ‘map’ of communication flows was provided, showing both what was expected and what was unexpected and potentially inappropriate. When set against a timeline of key events, the nature of such communications can prove to be a powerful tool to detect fraud and corruption.

Case study 3

2.15 PKF were asked to investigation persistent allegations concerning the country manager of a mining company with concessions in West Africa. PKF assessed the strength of the allegations, gathered evidence to see if the allegations could be substantiated, and provided a report to our client, allowing them to make necessary judgements concerning appropriate action.

2.16 A full range of investigative techniques were used, including witness interviews, electronic analysis of Emails, and communications mapping, to provide a professional, objective view of the position.
3 //

how quickly can losses be reduced and by how much?
3.1 Organisations have been measuring and reducing other types of business cost for decades – usually with progressively smaller reductions as time has gone by – but they have mostly not been doing this in respect of the cost of fraud. Indeed, it is still possible to hear those leading sizeable private or public sector organisations assert that ‘there is no fraud in my organisation’. Such comments show a lack of understanding that the first step to solving a problem is to stop being in denial about it. Even where such attitudes are not prevalent, it is still common that organisations have a reactive approach, acting primarily after fraud has taken place and after the losses have been incurred.

3.2 The Financial Cost of Fraud Report 2011 refers to examples where losses have been reduced. Where losses have been measured, and the organisations concerned have accurate information about their nature and extent, they have been substantially reduced.

3.3 The best examples over the 12 year period covered by this Report include from the UK:

3.3.1 where one organisation reduced its losses by up to 60%, and by up to 40% within 12 months;

3.3.2 where another organisation successfully reduced its losses by 50% between 1997/98 and 2005/06.

3.4 The best examples over the 12 year period covered by this Report include from the US:

3.4.1 where one organisation reduced its losses across a $US 12 billion program by 35% between 2001 and 2005;

3.4.2 where another organisation reduced its losses across a $US 12 billion program by 28% between 2002 and 2004; and

3.5 Even during the two years after the start of the recession, and in the middle of a period during which fraud losses increased by over 30%, 6 two of the organisations included in this research reported very significant reductions in their losses – one by 33% and the other by 19% - within a single year in each case. As can be seen, the speed of reduction of losses will vary from organisation to organisation, but it is not unreasonable to assert that losses can be reduced by 40% over a two year period – this is what the data shows.

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6 “The Financial Cost of Fraud Report 2011” - Jim Gee, Dr Mark Button and Graham Brooks
what would such a reduction in fraud losses mean?
4.1 This section of the Report reviews data from mining companies to provide an answer.

93 FTSE registered mining companies

4.2 In the commercial sector, fraud has a significant effect on profitability. A summary of 94 FTSE registered mining companies for 2011 - 2012 shows that they had total annual revenues of £281.33 billion, with pre-tax profits of £47.75 billion, representing 17% of revenues. Applying the global average loss rate (5.7%), derived from where losses have been accurately measured, would imply that losses total £16.03 billion, 33.5% of the total profits of these companies.

4.3 What would such a reduction in the cost of fraud mean in financial terms? The beneficial effects to the mining sector are impressive. Of the 50 companies which made profits 16 would increase their profitability by between 0 - 5%; 20 would do so by between 6 - 10%; 12 would do so by between 11 - 60%; with two companies increasing their profitability by 75% and 106% respectively.

4.4 Of the 43 companies which made losses; two would make a profit not a loss; two reported no turnover and therefore would not gain; 33 would reduce their losses by up to 10%; and six would reduce their losses by between 11 - 50%. This would represent a massive boost to corporate health.

4.5 The profitability of the sector would be boosted by £6.4 billion or over 13%. The proportion of companies that would increase their profitability is indicated below:

The 58 largest mining companies

4.6 A summary of 58 of the world’s largest mining companies for which data was available for 2011 - 2012 shows that they had total annual revenues of $US 734.1 billion, with pre-tax profits of $US 114.92 billion, representing 15.65% of revenues. Applying the global average loss rate (5.7%), derived from where losses have been accurately measured, would imply that losses total $US 41.84 billion, 36.4% of the total profits of these companies.

4.7 All of these companies reported making profits for the year but the beneficial effects to the sector are impressive. 27 would increase their profitability by between 3 - 10%; 27 would do so by between 11 - 100%; and four would do so by over 100%.

4.8 The profitability of the sector would be boosted by $US 16.7 billion or over 14%. The proportion of companies that would increase their profitability is indicated below:

// what would such a reduction in fraud losses mean?
5 // conclusion
5.1 The competitive advantage to be derived from the measurement and reduction of the cost of fraud could not be clearer. By ensuring that resources are not diverted from where it is intended they be applied, there are real competitive and financial advantages to be reaped.

5.2 We now have the tools to accurately measure fraud as a business cost, and to focus our skills and resources on reducing that cost. Rapid reductions have been shown to be possible and there are very significant financial benefits which can be delivered. As with any new way of doing things, the question initially is ‘Why would we do that?’ – it is now becoming ‘Why wouldn’t we do that?’.

5.3 This report highlights why and how companies operating in the mining sector can start to manage their fraud costs, just as they routinely manage other costs. The statistics revealed indicate that this sector has much to gain from this approach. In such a highly competitive market any opportunity to reduce costs must be an attractive proposition.

5.4 As with other significant developments in business, the new approach is simply a result of looking at a problem in a different way, and then developing the related methodologies. The barriers to progress are often in the mind, not in reality. If you consider fraud just to be a crime, then you police it; if you think of it as a business cost like any other then you manage and reduce it. The new approach has now been tested in organisations from across the world and has delivered proven results. And, as ever, now that this has happened, those who follow next will reap the greatest competitive advantage.

5.5 A first step may be to use PKF’s **FREE** Fraud Resilience Self-Assessment Tool, which draws on data from the two largest databases in the world concerning fraud losses and fraud resilience, to rate and rank organisations and to provide an indicative figure for the financial cost of fraud. The UK Government has endorsed this methodology and the tool can be accessed at www.pkfapps.co.uk/fraud.
appendix

fraud cost and resilience checks
how much does fraud cost your business and how resilient is it to fraud?

Fraud is a problem that undermines the stability and financial health of mining companies from across the world. It is not a victimless crime, but one which undermines their profitability and capacity for a beneficial impact locally.

Global research shows that fraud costs organisations an average of 5.7% of expenditure but also that this figure varies considerably according to how resilient to fraud they are.

PKF (UK) LLP and the Centre for Counter Fraud Studies (CCFS) at University of Portsmouth have jointly undertaken the most extensive and most comprehensive research yet in this area and now have the world’s largest databases concerning measured fraud losses and fraud resilience.

One affects the other - the more resilient to fraud that a company is the lower its losses will be. By increasing levels of fraud resilience losses have been cut by up to 40% within 12 months.

by combining specialist experience and academic rigour…

PKF and the CCFS represent a unique combination of specialist hands on experience, academic knowledge and rigour, and mining sector expertise. Together we offer a confidential Fraud Resilience Review service which rates and benchmarks companies against both best practice and their peers. This service reviews counter fraud arrangements against 29 measures of resilience and 170 different criteria derived from the best professional standards. We have delivered this service to mining companies in Africa and Asia.

The review covers:

- the extent to which an organisation understands the nature and cost of fraud to it as a business problem;
- the extent to which it has an effective strategy in place which is tailored to address this problem;
- the extent to which organisations maintain a counter fraud structure which can implement this strategy successfully;
- the extent to which the structure efficiently undertakes a range of pre-emptive and reactive action; and
- the extent to which results are properly measured, identified and delivered.

…we can provide the answers

We let the data speak for itself to identify weaknesses in counter fraud arrangements. Our work results in the provision of a clear and concise Report detailing our findings with recommendations for improvements based on a wealth of experience drawn from more than 30 countries around the world.

find out more

The cost of the Fraud Cost and Resilience Review service varies according to the nature, size and complexity of the company concerned. However, it is designed to be a cost-effective response to fraud which provides information and evidence to allow further decisions to be made.

To find out more please ring +44 (0)20 7065 0557 or email jim.gee@uk.pkf.com

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about the authors

Jim Gee is Director of Counter Fraud Services at PKF (UK) LLP, the leading accountancy and business services firm and Chair of the Centre for Counter Fraud Studies at University of Portsmouth.

During more than 25 years as a counter fraud specialist, he led the team which cleaned up one of the most corrupt local authorities in the UK - London Borough of Lambeth - in the late 1990s; he advised the House of Commons Social Security Select Committee on fraud and Rt. Hon. Frank Field M.P. during his time as Minister of State for Welfare Reform; between 1998 and 2006 he was Director of Counter Fraud Services for the Department of Health and CEO of the NHS Counter Fraud Service, achieving reductions in losses of up to 60% and financial benefits equivalent to a 12 : 1 return on the costs of the work.

Between 2004 and 2006 he was the founding Director-General of the European Healthcare Fraud and Corruption Network; and he has since worked as a senior advisor to the UK Attorney-General on the UK Government’s Fraud Review as well as delivering counter fraud and regulatory services to public bodies and private companies both in this country and internationally. He has worked with organisations from more than 35 countries to counter fraud including for mining companies in Africa and South East Asia. He has also advised the Chinese Government about how to measure, pre-empt and reduce the financial cost of fraud.

Dr Mark Button is a Reader at University of Portsmouth and Director of the Centre for Counter Fraud Studies.

Mark Button is a Reader in Criminology and Associate Head Curriculum at the Institute of Criminal Justice Studies, University of Portsmouth. He has also recently founded the Centre for Counter Fraud Studies of which he is Director.

He has written extensively on counter fraud and private policing issues, publishing many articles, chapters and completing four books with one forthcoming: Private Security (published by Perpetuity Press and co-authored with the Rt. Hon. Bruce George MP), Private Policing (published by Willan), Security Officers and Policing (Published by Ashgate), Doing Security (Published by Palgrave), and Understanding Fraud: Issues in White Collar Crime (to be published by Palgrave in early 2010 and co-authored). He is also a Director of the Security Institute, and Chairs its Academic Board, and a member of the editorial advisory board of ‘Security Journal’.

Mark founded the BSc (Hons) in Risk and Security Management, the BSc (Hons) in Counter Fraud and Criminal Justice Studies and the MSc in Counter Fraud and Counter Corruption Studies at Portsmouth University and is Head of Secretariat of the Counter Fraud Professional Accreditation Board (CFPAB). Before joining the University of Portsmouth he worked as a Research Assistant to the Rt. Hon. Bruce George MP specialising in policing, security and home affairs issues.

He completed his undergraduate studies at the University of Exeter, his Masters at the University of Warwick and his Doctorate at the London School of Economics. Mark has recently been working on a research project funded by the National Fraud Authority and ACPO looking at victims of fraud.
about the publishing organisations

PKF Forensic Services
PKF (UK) LLP is one of the leading firms of accountants and business advisers in the UK offering counter fraud, forensic accounting, expert witness and litigation support services on a national and international basis including:

- fraud resilience checks
- fraud loss measurement and reduction
- asset tracing and confiscations
- forensic IT, including data mining, data imaging and recovery
- fraud and financial investigations

www.pkf.co.uk

The Centre for Counter Fraud Studies at University of Portsmouth
The University of Portsmouth’s Centre for Counter Fraud Studies (CCFS) was founded in June 2009 and is one of the specialist research centres in the University's Institute of Criminal Justice Studies. It was founded to establish better understanding of fraud and how to combat it through rigorous research. The Institute of Criminal Justice Studies is home to researchers from a wide cross-section of disciplines and provides a clear focus for research, knowledge transfer and educational provision to the counter fraud community. The Centre for Counter Fraud Studies makes its independent research findings available to support those working in counter fraud by providing the latest and best information on the effectiveness of counter fraud strategies.

www.port.ac.uk/departments/academic/icjs/CentreforCounterFraudStudies
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PKF (UK) LLP is one of the UK’s leading firms of accountants and business advisers and specialises in advising the management of developing private and public businesses. We pride ourselves on creating and sustaining supportive relationships where objective and timely advice enables our clients to thrive and develop.

Our clients benefit from an integrated approach based on understanding the key issues facing small and medium-sized businesses. This enables us to meet their needs at each stage of development and allows them to focus on building the value of their businesses.

The principal services we provide include assurance and advisory; consultancy; corporate finance; corporate recovery and insolvency; forensic and taxation. We also offer financial services through our FSA authorised company, PKF Financial Planning Limited.

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- Hotel consultancy
- Healthcare
- Mining & resource
- Not-for-profit
- Pensions
- Professional practices
- Public sector
- Real estate & construction

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